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FISCAL IMPACT REPORT

SPONSOR: Boitano DATE TYPED: 3/8/03 HB _____

SHORT TITLE: Tuition Scholarships Tax Credit SB 237

ANALYST: Neel

REVENUE

Estimated Revenue		Subsequent Years Impact	Recurring or Non-Rec	Fund Affected
FY03	FY04			
	(\$6,000.0)	(\$6,000.0)	Recurring	General Fund

(Parenthesis () Indicate Revenue Decreases)

SOURCES OF INFORMATION

LFC files

Responses Received From

Taxation and Revenue Department (TRD)
State Department of Education (SDE)

SUMMARY

Synopsis of Bill

Senate Bill 237 enacts a new section of the Income Tax Act to allow New Mexico taxpayers who makes a contribution to a school tuition organization. The “tuition scholarship tax credit” may not exceed \$500 in any taxable year (or \$250 each for a husband and wife who file separate returns for a taxable year in which they could have filed a joint return). The tuition scholarship tax credit is not allowed for a contribution that is included in the taxpayer’s itemized deductions. For purposes of the tuition scholarship tax credit, a “qualified school” means an accredited non-governmental elementary or secondary school in New Mexico. The bill does not preclude the taxpayer from making a contribution that will be used for the direct benefit of the taxpayer’s dependent.

FISCAL IMPLICATIONS

TRD notes the following assumptions:

This estimate is an approximation. Statistics on the National Center for Charitable Statistics web site (http://nccs.urban.org/stcover/1992/stf_NM92.htm) suggest total annual giving for elementary and secondary institutions in New Mexico was \$17 million in 1992. This amount has probably grown to over \$30 million per year. The estimate assumes 20 percent of these donations will apply to qualified expenditures under the proposal. As a point of comparison, I.R.S. data on charitable contributions indicate that contributions to educational institutions comprise approximately 4% of total itemized deductions each year. About \$3 billion in total itemized deductions are reported each year in New Mexico. 4% of this amount is \$120 million. The estimate thus assumes a small proportion of total itemized deductions will be converted to credits under the proposal.

ADMINISTRATIVE IMPLICATIONS

TRD notes minimal administrative impact

OTHER SUBSTANTIVE ISSUES

SDE has provided the following background:

- It appears that SB 237 would allow the establishment of a “school tuition organization” (“STO”) to benefit the students that attend a specific nongovernmental elementary or secondary school. SB 237 may allow a parent to donate \$500 to an STO for the benefit of his or her child and claim the tax credit.
- The Education Commission of the States website (www.ecs.org) notes that Arizona, Florida, Illinois, Iowa, Minnesota, Pennsylvania and Puerto Rico have adopted either a tax credit or tax deduction program.
- Arizona Revised Statute § 43-1089 permits state tax credits for contributions to STOs. The Arizona statute requires that the organizations spend at least 90% of their revenue on scholarships, that recipients of the STO’s scholarships must be drawn from at least two schools, that a taxpayer cannot request that contribution to an STO be used for the direct benefit of his dependent and that an STO cannot distribute grants or scholarships to students who attend schools that discriminate on the basis of race, color, handicap, familial status or national origin. In *Winn v. Killian*, 307 F.3d 1011 (9th Cir. 2002), the Ninth Circuit Court of Appeals reversed and remanded a lower court dismissal of a lawsuit by Arizona taxpayers challenging the constitutionality of the Arizona statute as relating to contributions supporting parochial schools. The Court concluded that the challenge was not precluded from challenge in federal court by the Tax Injunction Act. In a footnote to the opinion, the Court distinguished a tax credit program from a tax deduction, noting that “[I]n the case of a tax credit, the taxes due are reduced by the full amount of the gift.” *Winn*, 307 P.3d at 1015. In an earlier challenge to the Arizona statute, the Supreme Court of Arizona in *Kotterman v. Killian*, 193 Ariz. 273, 972 P.2d 606 (1999), U.S. cert. denied, US Lx 4825, concluded that the statute did not violate the Establishment Clause of the U.S. Constitution in that “the Arizona school tuition tax credit is one of an extensive assortment of tax saving mechanisms available as part of a ‘genuine system of tax laws.’” *Kotterman*, 972 P.2d at 613, quoting *Mueller v. Allen*, 463 U.S. 388, 396 n. 6, 103 S.Ct. 3062, 77 L.Ed.2d 721 (1983). The Supreme Court of Arizona did not agree

with the position urged by the petitioners that tax credits are constitutionally different from tax deductions. The Court was not persuaded by the argument that the tax provision at issue did not provide a credit for those who wished to support public education, noting that the state tax code allowed a credit of up to \$200 for fees paid by taxpayers in support of public school extracurricular activities. The Court also rejected challenges under the Arizona Constitution. As to the challenge under Article II, Section 12 (“No public money or property shall be appropriated for or applied to any religious worship, exercise or instruction, or to the support of any religious establishment”), the Court rejected the argument that a tax credit constituted public money; the Court further observed that direct spending programs and tax expenditures are not fully equated for purposes of an Establishment Clause analysis. *Kotterman*, 972 P.2d at 619. With regard to the challenge under Article IX, Section 7 (“the state shall not ‘give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation’”), the Court observed that the history of a constitutional provision influences future interpretations. The Court proceeded to note that contemporary tax codes, both state and federal, permit churches and other religious institutions to acquire tax-free status and allow deductions for contributions made to such entities. *Kotterman*, 972 P.2d at 623. The U.S. Supreme Court declined to review the decision.

- The Minnesota statute challenged in *Mueller v. Allen* permitted state taxpayers to claim a deduction from gross income for certain expenses of educating their children. The deduction was limited to actual expenses incurred for “tuition, textbooks, and transportation” of dependents attending elementary or secondary schools, was limited in dollar amount and was available to all parents. The U.S. Supreme Court distinguished the statute from that held to be constitutionally infirm in *Nyquist*, holding that the Establishment Clause prohibition did not extend to the type of tax deduction envisioned by Minnesota, i.e., “an attenuated financial benefit, ultimately controlled by the private choices of individual parents, that eventually flows to the parochial schools from the neutrally available” tax credits. *Mueller v. Allen*, 463 U.S. 388, 103 S.Ct. 3062, 77 Ed.2d 721 (1983). The Supreme Court found in *Mueller* that (1) an essential feature of Minnesota’s arrangement was the fact that the deduction was only one among many available deductions, such as those for medical expenses and charitable contributions; (2) unlike the arrangement struck down in *Committee for Public Education v. Nyquist*, 413 U.S. 756, 93 S.Ct. 2955, 37 L.Ed.2d 99948 (1973), the Minnesota arrangement permitted all parents – whether their children attended public school or private – to deduct their children’s educational expenses; and (3) public funds became available only as the result of numerous private choices of individual parents of school-age children.